

***United States Court of Appeals
for the Second Circuit***



**APPELLANT'S
BRIEF**

ORIGINAL
WITH PROOF
OF SERVICE

77-7098

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

B

RICHARD I. CLARK, as Executor of the
Estate of BERNICE C. GRUPE,

P/S

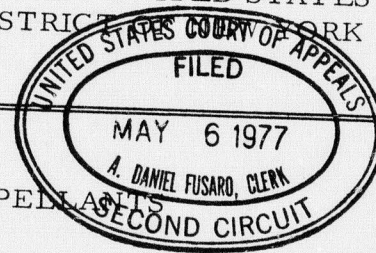
Plaintiff-Appellee,

-against-

JOHN LAMULA INVESTORS, INC. and
JOHN J. LAMULA,

Defendants-Appellants.

ON APPEAL FROM A FINAL JUDGMENT OF THE UNITED STATES
DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK



BRIEF OF DEFENDANTS-APPELLANTS

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UNITED STATES COURT OF APPEALS
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RICHARD I. CLARK, as Executor of the
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-against-

JOHN LAMULA INVESTORS, INC. and JOHN J.
LAMULA,

Defendants-Appellants.

75 Civ. 2083
Docket No. 77-7098

BRIEF OF DEFENDANTS-
APPELLANTS

ISSUES PRESENTED FOR REVIEW

1. In an action by a customer against a securities broker, may the customer recover damages under the anti-fraud provisions of the Securities Exchange Act of 1934 solely on the basis of a claimed violation of the "suitability" standards of the National Association of Securities Dealers, Inc?

This question must be answered in the Negative.

2. Did the Court below commit reversible error in itself referring and permitting counsel for the customer to refer continually to these debentures as "junk bonds", as well as in making other gratuitous and erroneous remarks during the trial?

This question must be answered in the Affirmative.

3. Did the Court below properly remove from the jury's review the questions of damages and the questions of mitigation and limitation thereof?

This question must be answered in the Negative.

4. Did the Court below improperly interpret the law regarding claimed "mispricing" of securities?

This question must be answered in the Affirmative.

STATEMENT OF THE CASE

This is an appeal by John Lamula Investors, Inc. (hereinafter "JLI"), a small securities brokerage firm, and its principal officer, John J. Lamula (hereinafter "Lamula") from a judgment of the United States District Court for the Southern District of New York entered by the Court (Goettel, J.) on November 29, 1976 after a jury trial of eight days' duration.

The complaint herein attempts to allege a series of claims seeking

(1) damages for Federal Securities Law fraud, chiefly for violation of the foregoing suitability standards;

(2) damages for breach of fiduciary duty in the markups discussed above; and

(3) damages for common law fraud, again principally depending on the suitability questions.

At the close of evidence, the Court submitted interrogatories to the jury, and, on the basis of the answers to the interrogatories (answers which were inconsistent and self-contradictory) determined that the jury had, in effect, rendered a verdict for plaintiff on certain issues and for defendants on others.

There was no finding of common law fraud. There was no finding of a breach of fiduciary duty upon which damages were based.

The Court thereupon directed that no issue remained for the jury on the damage issue and directed that counsel prepare a judgment in accordance with the formula directed by him.

The judgment entered was in the amount of \$29,311.96 with interest thereon from August 14, 1974. Costs were taxed in the sum of \$2,196.01.

Motions were made both informally after the verdict and formally in writing thereafter by both sides seeking orders setting aside the verdict or granting judgment notwithstanding the verdict. All motions were denied. The Notice of Appeal to this Court was filed on February 16, 1977.

STATEMENT OF FACTS

Defendant JLI is a corporation doing business as a small securities brokerage firm in New York City. Its expertise lies in the sale of convertible debentures of "special situation" companies which have been carefully evaluated and analyzed for long term investment potential at high yield. In essence, JLI deals in the convertible debentures, particularly of some 25 or 30 medium sized companies with small debenture issues selling at discounts of 20% to 50% so that current yield was 10% to 12% with maturity dates of ten to fifteen years. The potential profit is the difference between the purchase price of the bond and the face amount of each bond (\$1,000) received either through redemption from the sinking fund prior to maturity or upon the stated maturity date of the bond. JLI is not an investment advisory firm for real estate, gold, commodities or even most stocks and bonds.

Its principal officer is the defendant Lamula.

Lamula has been engaged in the brokerage business for many years in New York City. He has had a parallel career of some forty years duration in the State government in Albany, New York. He served in the State Legislature as an Assemblyman and served the State government in a variety of positions, including Deputy Clerk of the Assembly, Assistant to the Speaker, Assistant to the Majority Leader of the Assembly and consultant to the Senate Finance Committee (A-65). Lamula

enjoyed an unblemished reputation for honesty and integrity as well as for reliability and professionalism (A-1117).

Plaintiff, Mrs. Bernice C. Grupe (hereinafter "Mrs. Grupe") was twice married and twice divorced, the second time in December of 1973 (A-66, 152). At the time of the trial of this matter she was approximately sixty years of age (A-152). She received a settlement on her second divorce in the sum of \$138,000 in 1973 (A-153). She was educated as a teacher and received graduate training in education, ultimately obtaining her Masters degree in education (A-161). She held positions in education in various areas in upstate New York for approximately 23 years (A-158-63). She had also worked in business. Following her separation from her second husband in December 1973, Mrs. Grupe stopped in Albany and obtained employment with the New York State Senate as a "correspondent" (A-169-71).

In or about March or April of 1974, Mrs. Grupe was introduced to Lamula through a fellow State employee, Dorothy Emerson (A-172). Lamula was introduced as someone who was a financial adviser to the Senate and who had invested successfully for others in the Senate, including Miss Emerson (A-175). There followed a series of eight to ten meetings between and among Mrs. Grupe, Lamula and Miss Emerson, at which the subject of investments was discussed. At these meetings, Mrs. Grupe stated that she had an income requirement from these investments of \$1,000 per month.

In response to the interrogatories of the Court, the jury resolved the disputes as to the content of these discussions largely in defendants' favor finding that Lamula did not, in the course of these meetings, make "any untrue statements of fact" concerning the securities recommended to Mrs. Grupe (A-1324) and that Lamula had advised her of all material facts pertaining to these debentures (A-1327). A careful reading of the jury findings reveals some remarkable inconsistencies in the jury's findings which will be set forth herein.

According to the testimony of Miss Emerson, Lamula gave Mrs. Grupe a detailed and thorough review of each of the securities which he intended to purchase for her over at least eight meetings, totalling at least twenty hours of discussion on these debentures. He went over the companies' annual reports, reviewing terminology, discussing differences between bonds and stocks, reviewing his reasons for recommending the securities, which he did including the small size of the companies involved, and covering all of the above in great detail (A-382-440) and the jury so found (A-1327). All of the above was done to meet Mrs. Grupe's overriding investment requirement of an income of about \$1,000 per month, and was accomplished in the face of Lamula's recommendation that she use her broker in Buffalo rather than himself.

She purchased eleven different convertible debenture issues in the face amount of \$185,000 for an investment of \$105,000 with an income of \$11,612.50 per year (A-888), (an 11.1% return) with maturity dates from 1983-1990.

Subsequently, Mrs. Grupe made further inquiries on her own concerning the debentures in her portfolio with her nephew, and after discussing these debentures with another broker, and, after being persuaded that she did not wish to own them any longer, she sold them in August of 1974 at a substantial loss amounting, by the Court's determination, to the sum of \$29,311.96 (A-243-267). She unloaded these high income long term convertible debentures within three months after purchase, in one of the worst market conditions in memory -- two days before the resignation of President Nixon -- thereby thwarting the purpose for which she bought these debentures, i.e., high income and long term appreciation.

The jury also found in its answers to the interrogatories that JLI (but not Lamula) had charged Mrs. Grupe "an excessive amount" for the securities sold to her. This finding related to the contention of plaintiff that JLI's purchases of the debentures and subsequent resales to Mrs. Grupe represented an excessive markup to her. While

defendants consistently disputed this contention, it is of interest to note that the entire amount of purported gross profit to JLI was \$10,890 by plaintiff's calculation (A-86), a sum substantially less than the damages recovered; and, of course, representing a portion of the total difference between her purchase and sales prices.

The foregoing recitation of facts is set forth principally as background. The argument which follows will detail certain additional facts pertinent to the issues to be considered.

ARGUMENT

Defendants' position may be summarized from this voluminous record as follows:

1. Mrs. Grupe was an educated, sophisticated woman of the world.
2. She said she wanted to live a little on what other money she had plus an income of \$1,000 per month from her investment.
3. She didn't want to invest in stocks or real estate.
4. Other forms of suitable investments would not meet her income objectives.
5. Lamula was an expert in the complicated area of convertible debentures and had carefully evaluated each of these securities.
6. Lamula spoke to her at great length about all the facts concerning these convertible debentures and urged her to talk to her son, the lawyer, about these debentures, or to her broker in Buffalo; she refused to do so.
7. These debentures, because of the sinking fund and the other investment characteristics, were suitable for her income needs of \$1,000 per month.
8. Instead of holding these debentures to maturity or getting the benefit of the sinking fund, she dumped them on advice of a relative and another broker within ten (10) weeks after purchase, in a disastrous market (two days prior to President Nixon's resignation).

9. The vast majority of investments were losing value in this market and Mrs. Grupe refused to mitigate any loss by letting Lamula help her get out of these investments over a reasonable period of time.

10. Had she held these investments for a reasonable period, say two years, she would have received the income she needed and seen an appreciation in value.

11. Most of the debentures were sold out of inventory and Lamula was entitled to sell them at current market price.

12. The charge to the jury was misleading and inadequate based on the record in this case, particularly on the issue of scienter.

13. As a result of confusion and lack of understanding on the part of the jury, and prejudicial and erroneous remarks by the Court, the jury's findings were inconsistent.

14. No actionable wrong under the Federal Securities Law exists in the case at bar.

POINT I

A VIOLATION OF THE RULES OF THE
NATIONAL ASSOCIATION OF SECURITIES
DEALERS INC. DOES NOT CONSTITUTE
AN ACTIONABLE WRONG UNDER THE
FEDERAL SECURITIES LAWS.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C.
78j(b), reads as follows:

"Sec. 10. It shall be unlawful for any person,
directly or indirectly, by the use of any means
or instrumentality of interstate commerce or of
the mails, or of any facility of any national
securities exchange -

(a) . . .

(b) To use or employ, in connection with the
purchase or sale of any security registered on
a national securities exchange or any security
not so registered, any manipulative or deceptive
device or contrivance in contravention of such
rules and regulations as the Commission may
prescribe as necessary or appropriate in the
public interest or for the protection of investors."

Rule 10b-5, 17 CFR 240.10b-5, reads as follows:

"Rule 10b-5. Employment of Manipulative and Deceptive
Devices.

It shall be unlawful for any person, directly or indirectly,
by the use of any means or instrumentality of interstate
commerce, or of the mails, or of any facility of any
national securities exchange

(1) to employ any device, scheme, or artifice to
defraud;

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."

Article III, Sections 1 and 2 of the National Association of Securities Dealers, Inc. ("NASD") reads as follows:

"Sec. 1. A member, on the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade.

Sec. 2. In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs."

A review of the jury findings discloses an extremely limited group of findings adverse to defendants. It is contended that these findings taken separately or together do not make out a ground for a holding of Federal Securities Law fraud under any of applicable statutes set forth above. They found only that the securities were "unsuitable" for Mrs. Grupe (A-1323); that Mr. Lamula failed to inform

her of the availability of other investment opportunities and the risks involved in the recommended securities, although this was contradicted by other findings. The jury did not find that there were other available investments which could have met Mrs. Grupe's expressed needs which would have been suitable to her.

The Federal Courts have struggled to deal with the problem of whether or not rules adopted by self-regulatory bodies, whether securities exchanges or national securities associations, may be deemed to create any private right of action for their violation. In particular, the provisions of the NASD rules, chiefly the "suitability" standards set forth in Section 2 of Article IV, the "Rules of Fair Practice", have been held, generally, not to create any private right of action for their violation, without a good deal more.

In Colonial Realty Corporation v. Bache & Co., 358 F. 2d 178 (2d Cir. 1966), cert. denied 385 U.S. 817, this Court reviewed the development of self-regulatory rules and their relationship to the Federal regulatory scheme.

"What emerges is that whether the courts are to imply federal civil liability for violation of exchange or dealer association rules by a member cannot be determined on the simplistic all-or-nothing basis urged by the two parties; rather, the court must look to the nature of the particular rule and its place in the regulatory scheme, with the party urging the implication of a federal liability carrying a considerably heavier burden of persuasion than when

the violation is of the statute or an SEC regulation.
The case for implication would be strongest when the rule imposes an explicit duty unknown to the common law. The rules here at issue, (the NASD Rules of Fair Practice) however, are near the opposite pole. Although they do impose a duty upon members not to engage in conduct inconsistent with fair and equitable principles of trade, which the exchange or association can enforce through disciplinary proceedings, they are something of a catch-all which, in addition to satisfying the letter of the statute, preserves power to discipline members for a wide variety of misconduct, including merely unethical behavior which Congress could well not have intended to give rise to a legal claim. We find little reason to believe that by requiring exchanges and dealers' associations to include such provisions in their rules Congress meant to impose a new legal standard on members different from that long recognized by state law. See Note, Implying Civil Remedies From Federal Regulatory Statutes, 77 Harv.L.Rev. 285, 292 (1963). 358 F. 2d 178, 182 (emphasis added)."

Since Colonial Realty, the courts have developed an even more restrictive view toward implying Securities Law liability in a variety of circumstances, perhaps with an eye towards the ever-proliferating numbers of cases being placed on the shoulders of the Federal Courts which, in reality, represent nothing more than traditional "garden variety" broker-customer disputes. Perhaps it might be argued that Mr. Lamula used poor professional judgment in his selection of securities for Mrs. Grupe; perhaps, even that he was in some way negligent; but not that he committed an actionable Federal Securities Law fraud in so doing.

Utah State University v. Bear, Stearns & Co., 549 F. 2d 164 (10th Cir. Jan. 24, 1977) holds, in a case dealing with the NASD suitability rule, that the court reviewed the topic of actionability and found that such application should be severely limited.

"In an appropriate case a rule violation may give rise to a private cause of action. At the same time there is good reason to limit the scope of potential liability of brokers for rule violations. The advantages of self-regulation in the securities field may not be denied. Self-regulation obviates need for a more massive governmental bureaucracy and a detailed and rigid regulation of the entire securities field . . . For the system to work effectively, the self-regulatory bodies must be encouraged to take the initiative in exploring and formulating new rules to govern the conduct of their members. Such action is doubtful if the promulgation of every new rule has the potential of creating massive liability for the members.

No provision of the Securities Exchange Act creates an express civil remedy for violation of an exchange or association rule. In Ernst & Ernst v. Hochfelder, 425 U.S. 185, 96 S. Ct. 1375, 47 L. Ed. 2d 668, the Supreme Court rejected a private implied claim for violation of SEC Rule 10b-5. The Court said, Ibid. at 207, 96 S. Ct. at 1388, that: 'In each instance that Congress created express civil liability in favor of purchasers or sellers of securities it clearly specified whether recovery was to be premised on knowing or intentional conduct, negligence, or entirely innocent mistake.' With reference to Rule 10b-5, the Court said, Ibid. at 206, 96 S. Ct. at 1387 that: 'There is no indication that Congress intended anyone to be made liable for such practices unless he acted other than in good faith.'

Applying the statements of the Court to claims asserted under association and exchange rules, something more than mistake or negligence must be shown. The allegations of the complaints are that the stocks were too speculative for USU, did not have earnings records showing suitability for purchase by USU, the stocks were purchased in too great quantities, the stocks were too thinly traded, and the purchase of the stocks by USU was ultra vires. No complaint has an allegation of fraud or bad faith. The allegations, taken separately or together, are not tantamount to fraud. 549 F. 2d 164, 168."

The District Court of Connecticut, following the Second Circuit's Colonial Realty reasoning held in Plunkett v. Dominick & Dominick, Inc., (1976-77 Dec.) CCH Fed. Sec. L. Rep. Para. 95,728 (D. Conn. April 27, 1976) as follows: "I conclude that neither the suitability nor the supervision rules at issue here should be the basis for federal court damage actions." Para. 95,728 at p. 90,562.

In Rolf v. Blyth Eastman Dillon & Co., Inc. (1976-77 Dec.) CCH Fed. Sec. L. Rep. Para. 95,843 (SDNY Jan. 18, 1977), Judge Pierce held that the rules in question here may give rise to an implied right of action but only where the violations are "tantamount to fraud" and that a part of the proof must be that defendants "acted with scienter." Para. 95,843 at page 91,058. In the case at bar the jury answered Interrogatory 3-a by saying that Mr. Lamula did not make any untrue statements of fact about the debentures to Mrs. Grupe, and therefore the intention to deceive question of Interrogatory 3-b did not have to be answered.

In Parsons v. Hornblower & Weeks-Hemphill, Noyes, Incorporated, (1976-77 Dec.) CCH Fed. Sec. L. Rep. Para. 95,885 (M.D.N.C. Feb. 9, 1977), that court, again following Colonial Realty holds absolutely that the NASD suitability standards do not create any private right of action.

As stated above, the cases vary in their conclusions with respect to the actionability of the NASD suitability standards ranging from absolute denial of any claimed implied liability to, at the most, a highly restricted right, dependent upon proof, not of a technical violation but rather of one where the factual circumstances contain all of the elements of a fraud, including the scienter requirement imposed by Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

An examination of the complaint herein (A-4-14) discloses a series of claims which relate solely to alleged violations of the suitability standards. The facts purportedly constituting misstatements or omissions by Lamula and which are alleged in an attempt to characterize the suitability matter as a fraud are nothing more than a rehashing of the rule. Indeed, the proof at trial and the jury's findings (putting aside the "markup" or mispricing matters) all relate to recommending unsuitable securities and then restating the same claim by saying that Lamula failed to disclose facts indicating the unsuitable nature of the securities. Merely adding to an unsuit-

ability claim a claim that the broker failed to inform the customer of the unsuitability is not enough to bring the violation within the "tantamount to fraud" standard. Every violation of the suitability standards must, by its very nature, include such a non-disclosure.

The Court below erred, both in constructing the questions for the jury which created the implication that the omissions presented to them in question 6 (A-1327) formed the basis for some form of relief, and in interpreting the answers thereto as creating a ground for recovery. All that was found was that Mr. Lamula made selections of securities unsuitable to Mrs. Grupe's needs and failed to disclose that unsuitability to her. This finding is itself based on clearly prejudicial, erroneously admitted evidence. Neither Lamula, nor anyone else for that matter who is in the securities business, should be liable where, as here, plaintiff permitted no opportunity for suitability by selling a long term investment in ten weeks. This is insufficient for securities law actionability.

The Court also erred in foreclosing defendants from tracing the subsequent history of the debentures, which would have shown that the debentures were suitable for, and in fact did meet, the investment criteria set forth by Mrs. Grupe to Mr. Lamula in their initial meeting. By precluding this testimony (A-618) defendants

never had a chance to prove that he was correct since suitability could never be evaluated in debentures of this kind over a ten week period, particularly in the disastrous market preceding the Nixon resignation (A-844). A reasonable period of time, at least two years, should have been the criteria but the Court below would not permit such proof. Had this proof been permitted, it would have shown that Mrs. Grupe's portfolio had appreciated roughly 35% in value in addition to the fact that she would still be getting 11% income during the elapsed period.

POINT II

THE DISTRICT COURT COMMITTED REVERSIBLE ERRORS IN ITSELF USING AND PERMITTING THE TERM "JUNK BONDS" TO BE USED BEFORE THE JURY AS WELL AS IN OTHER GRATUITOUS AND ERRONEOUS REMARKS BY THE COURT.

The jury's finding of unsuitability must be viewed in the light of the evidence presented at trial with respect to the investment quality of the securities which Mrs. Grupe purchased through defendants. Throughout the course of the trial from opening statements (A-128) through the testimony of plaintiff's purported expert (A-229-351) and thereafter the securities purchased by plaintiff were referred to as "junk bonds" by plaintiff and the Court (A-492, 494). Such a term is clearly highly inflammatory and erroneous when applied to these debentures, and coming from the Court as well as a so-called expert, must be viewed as having an extremely prejudicial effect on the jury, permeating their entire consideration of the issues, especially where the crucial issue sought to be determined by them is suitability. The use of this term was objected to by defense counsel from the time of its first use (A-128) and ruled admissible by the Court (A-129).

Similarly, plaintiff's expert could have made whatever case was necessary to make concerning the investment merits of the portfolio, up to and including his opinion as to the ultimate issue

of suitability to plaintiff's needs (Rule 704 Federal Rules of Evidence) without the use of this characterization. The sole effect sought by plaintiff beyond the legitimate proffer of expert opinion testimony could only have been to influence and prejudice the jury. That this was accomplished is beyond doubt. Rule 103 of the Federal Rules of Evidence permits reversal on appeal where a substantial right of a party is affected, particularly in the case of "plain error".

The charge to the jury (A-1233-1278), in such a complicated factual case such as this, was misleading and inadequate, particularly in light of the scienter requirement imposed by Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976).

Likewise, permeating and prejudicing this entire trial were several gratuitous remarks which, in a highly technical area such as convertible debentures, made it appear to the jury that the judge himself thought that these debentures were a "gamble" or in some way unsuitable.

While a little humor is a good thing, the trial Court's reference to Jimmy the Greek (A-609), the shaky financial situation of New York City (A-605), the "This is Your Life" television program (A-743), Triple C's as being a shoe size (A-338), as well as the Court's erroneous discussion of this complicated area (A-465, 475, 492), all created an unmistakably prejudicial atmosphere for the jury and contributed to the obvious confusion and inconsistency in the findings on the interrogatories.

POINT III

THE FINDINGS OF THE JURY ARE
INCONSISTENT.

The inconsistent findings of the jury are best exemplified by its findings that, while Lamula made no untrue statement of facts about the debenture on which she relied (Int. 3-a, A-1324), and while Mr. Lamula informed Mrs. Grupe of market conditions, market activity, market price (Int. 6-b, A-1327) and other material matters respecting the debenture, the companies issuing them and their market quality (Int. 6-c, A-1327) and that she was not entirely dependent on Lamula for investment guidance in selecting her investments (Int. 12-a, A-1331), the securities were "unsuitable".

While fully aware of the fact that juries do strange things, such a finding of unsuitability in the face of the other findings it made could only be the product of confusion, lack of knowledge of an admittedly difficult subject matter compounded by the prejudicial remarks and erroneous statements of the trial judge.

It was Mrs. Grupe who defined her investment needs of approximately \$12,000 per year income to Mr. Lamula. It was Mrs. Grupe who established the very narrow criteria the Mr. Lamula had to work within. It was Mrs. Grupe who defined what was "suitable" for herself when she set forth her objectives while stating that she didn't want to

invest in stocks or real estate, and that she wanted to live a bit now and was not interested in leaving an estate (A-332). In setting forth her suitability criteria, she, not Mr. Lamula, defined the suitable investments.

When the above findings are coupled with the finding that Mrs. Grupe did not act reasonably in the manner in which she had sold these securities (Int. 16, A-1334), i.e., within ten weeks after purchase, on advice of her nephew, two days before the Nixon resignation in a horrendous market, it is inconsistent that a jury could find against defendants on the suitability question.

POINT IV

THE DISTRICT COURT ERRED IN ITS METHOD OF CALCULATION OF DAMAGES.

The District Court used as a method of calculation of damages the difference between Mrs. Grupe's purchase and sales prices, with from the jury the question as to the relationship between and among the various factors resulting in the loss. There was substantial evidence, both from plaintiff's witnesses and from defendants', that the summer of 1974 had dramatic forces operating on the market, not the least of which was the possibility of President Nixon's impeachment. Obviously, these forces would affect any investment made by Mrs. Grupe, not only the allegedly unsuitable ones actually made.

In the face of this market, and despite Mr. Lamula's offer to dispose of these debentures in a reasonable period of time to minimize Mrs. Grupe's loss, she failed to mitigate and dumped these debentures at the worst possible moment.

The Court, however, simply assumed that the damages were equal to Mrs. Grupe's losses (A-1317) and directed counsel to compute the exact amount thereof.

In Cutner v. Fried, CCH Fed. Sec. L. Rep. Para. 94,432 (SDNY 1974), the Court commented on the relationship between damages and causation as follows:

"The issues of damages and causation are so closely related that they cannot be separated for purposes of analysis. Plaintiff contends, in essence, that defendants' alleged wrongful acts artificially depressed the price of Skyline shares. Exactly what

portion of the reduction in the selling price is directly attributable to the suspension of trading remains to be seen. Other factors influencing the market as a whole, and Skyline stock in particular, must be identified and discounted from a calculation of a shareholder's damages. This is necessary to assure that a nexus exists between defendants' acts and plaintiff's loss."

The testimony of plaintiff's expert was to the effect that the market was in a state of great flux (A-499-451, A-491). The jury should have been allowed to consider the relative effect of these market forces and that of the selection of these particular securities. The failure to do so again constitutes grounds of reversible error.

POINT V

THE COURT'S INTERPRETATION OF THE
ISSUES PRESENTED BY THE CONTROVERSY
REGARDING "MARK-UPS" WAS IN ERROR.

Plaintiff attempted to prove at trial as an element of fraudulent conduct that defendants charged prices to Mrs. Grupe which were either not reasonably related to current market prices or that resulted in excessive "mark-ups" to her. The evidence at trial indicated defendants sold to Mrs. Grupe the convertible debentures in question as principal. Substantial testimony was offered as to the appropriate method for determining the price prevailing at the time of the various transactions and whether or not JLI's price was reasonably related thereto. In addition, substantial evidence was offered on the question of whether JLI was selling to Mrs. Grupe from its "inventory" as to which it was at risk or whether the transactions were "riskless" transactions and therefore subject to the mark-up rules of the NASD.

Firstly, it is to be noted that this controversy is wholly separate and apart from the question of the suitability of the securities recommended. The two are in no way interdependent. Accordingly, no argument that this conduct formed part of any fraudulent device or scheme so as to "bootstrap" the suitability problems referred to above into an actionable securities fraud can be sustained.

Apart from this issue, the question arises as to whether or not defendants have any liability to plaintiff on account of a violation of the NASD rule limiting mark-ups or commissions to specify percentages or amounts. The legal discussion of Point I above regarding actionability under the Federal Securities Laws of rule violations is applicable herein. The NASD's mark-up policy which plaintiff relied upon is subject to the same considerations as the suitability standards referred to therein.

Furthermore, a violation of such provision constitutes, again, not a securities fraud but, at most, a breach of fiduciary duty or similar obligation to plaintiff.

Further, the Court's interpretation of the rules regarding their application to situations where the broker purchases securities in his own account and for his own risk and then resells them to a customer was unduly restrictive. The Court's instruction at A-1265 fails to present to the jury adequately the problem of their determining whether or not JLI was at risk during the time when the debentures were held and whether Mrs. Grupe could have cancelled any orders in effect at the time and thereby left JLI with any resultant loss.

Accordingly, if the Court agrees that the suitability standards and the omissions found by the jury in connection therewith do not support a finding of actionable securities fraud or that the evidence admitted at trial in support of the claimed suitability violation was prejudicial error, then the Court will be obligated to deal with the foregoing questions regarding mark-ups. For the reasons stated, the District Court's interpretation of these issues is also erroneous.

CONCLUSION

THE VERDICT OF THE JURY AND THE
JUDGMENT AND ORDERS DENYING DE-
FENDANTS' MOTIONS SHOULD BE RE-
VERSED.

Respectfully submitted,

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STATE OF NEW YORK)
COUNTY OF NEW YORK) ss .

ERAN Oquendo, being duly sworn,
deposes and says that deponent is not a party to the action,
is over 18 years of age and resides at 5616
NEW UTRACHT Ave.

That on the 6th day of MAY, 19 77,
deponent personally served the within BRIEF OF DEFENDANTS-APPELLANTS

upon the attorneys designated below who represent the
indicated parties in this action and at the addresses below
stated which are those that have been designated by said
attorneys for that purpose.

By leaving 2 true copies of same with a duly
authorized person at their designated office.

~~By depositing true copies of same enclosed~~
~~in a postpaid properly addressed wrapper, in the post office~~
~~or official depository under the exclusive care and custody~~
~~of the United States post office department within the State~~
~~of New York.~~

Names of attorneys served, together with the names
of the clients represented and the attorneys' designated
addresses

SILBERFELD, DANZIGER & BANGSER
Attorneys for Plaintiff-Appellee
230 Park Ave.
New York, N. Y. 10017

Ernan Oquendo

Sworn to before me this

6th day of MAY, 19 77.

Michael DeSantis

MICHAEL DeSANTIS
Notary Public, State of New York
No. 03-0930908
Qualified in Queens County
Commission Expires March 30, 1979